SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1940.

No. 490

INTERNATIONAL COMPANY OF ST. LOUIS, a Corporation, Petitioner,

vs.

E. R. SLOAN, Receiver of The Federal Reserve Life Insurance Company, a Corporation, and OCCIDENTAL LIFE INSURANCE COMPANY, a Corporation.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Tenth Circuit

and

SUPPORTING BRIEF.

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Cases Cited.

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To the United States Circuit Court of Appeals
For the Tenth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Now comes International Company of St. Louis, a corporation, petitioner, and respectfully petitions this Honorable Court to grant a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit, and to remove therefrom to this court, for review, the record in the case lately pending in said Circuit Court of Appeals styled International Company of St. Louis, a corporation, appellant, v. E. R. Sloan, Receiver of The Federal Reserve

Life Insurance Company, a corporation, and Occidental Life Insurance Company, a corporation, appellees, being cause No. 2006 on the docket of said Circuit Court of Appeals. The duly certified record, including all the proceedings in the District Court of the United States for the District of Kansas, where said cause was heard, and in the said Circuit Court of Appeals, to which an appeal was taken by petitioner from the judgment of the trial court, is filed herewith under separate cover.

Your petitioner represents that it is aggrieved by the decision and judgment of said Circuit Court of Appeals in said cause wherein said Circuit Court of Appeals on July 12, 1940, affirmed the judgment of the trial court, and on August 12, 1940, thereafter denied this petitioner's petition for a rehearing of said cause.

Your petitioner states that the opinion to be reviewed is in conflict with prior opinions of this Court and with prior opinions rendered by the Circuit Court of Appeals of the Tenth Circuit itself and other courts of appeals on the propositions of general law therein announced, and that the matters of issue in said cause are of peculiar gravity and great general importance in that the following are the principal questions presented:

QUESTIONS PRESENTED.

1. Under what circumstances does a person advancing money to a corporation, under a written contract for its repayment, become a stockholder of the corporation, and under what circumstances is such person to be regarded as a creditor?

2. Where a life insurance company, in order to restore its reserve fund held for the benefit of its policyholders, borrows money upon a written agreement that the money

so borrowed, together with interest at 6 per cent, shall be repaid by the company only out of net surplus gains of the company in excess of $50,000.00, and where the agreement further provides that in the event of a reinsurance of the business of the borrowing company the reinsuring company shall be bound each six months to pay the savings and profits arising out of the reinsured business to the lender or its assigns until the principal and interest have been paid, and where the company, without discharging this obligation, becomes again insolvent and a receiver is appointed and the insurance business of the insolvent company is reinsured under a contract of reinsurance entered into by the Receiver under order of the Court with another insurance company, and where, at the time the reinsurance contract is entered into, both the Court and the Receiver and the reinsuring company had knowledge that the money so borrowed had not been repaid; can the provision in the agreement under which the money was advanced to the effect that the reinsuring company shall be bound to repay it out of savings and profits of the reinsured business be disregarded, after such savings and profits are in fact realized, upon the theory that the lender and holder of the certificate occupies a position analogous to a stockholder and is entitled to repayment of the money advanced only after all other creditors have been satisfied?

3. It being recognized as true that the reserve fund of a life insurance company is a trust fund created for the benefit of its policyholders and that future savings and profits of a life insurance business constitute no part of such fund, and are potential assets of the corporation itself, can a life insurance company, for the purpose of borrowing money for restoring an impairment in its reserve, make a valid pledge of the future savings and profits of its insurance business consisting of excess inter-

est earnings, if any, profits on lapses, mortality savings and cash surrender charges, which pledge will be binding upon a future reinsurer of the business in insolvency proceedings who acquires such business under a reinsurance contract ordered and approved by the Court, when the reinsurer takes over the business with notice and knowledge of the existence of such outstanding contract and pledge of the insolvent insurance corporation?

4. Where the terms of such a contract are certain and definite as to the obligation of the reinsuring company in the event of a reinsurance of the business of the original obligor, can the Court properly interpolate words into the contract so as to limit the obligation and hold that, under the provisions of such contract in accordance with which the money was advanced, only a voluntary reinsurance was contemplated by the parties and that such provision as to the obligation of the reinsuring company had no reference to reinsurance of the business of an insolvent company in receivership proceedings?

5. Where a contract in the form of a certificate setting forth the obligation of an insurance corporation to repay money borrowed is prepared, issued and signed by the corporation and where it contains limitations upon the obligation therein set forth for the repayment of the money borrowed, is it in accordance with the recognized rules of construction to construe such contract most favorably to the borrower and interpolate qualifying words so as to impose further limitations, not set forth in the contract itself, on the obligation of the borrower or the reinsurer of its business to repay the money borrowed with a resulting holding that the obligation refers only to a voluntary reinsurance, though the contract itself provides for repayment of the money in the event of any reinsurance?

6. Can the interpretation placed upon a written contract

after its execution by only one of the parties, to wit, the obligor, in a contract for the payment of money, as shown by the method in which it keeps its books, be properly considered in determining the extent of the obligation imposed by the contract?

SUMMARY STATEMENT OF MATTER INVOLVED.

A brief and comprehensive statement of the matter involved is set forth in the opinion in this cause of the Court of Appeals for the Tenth Circuit (R. p. 182) as follows:

"The material facts are not in controversy. The Federal Reserve Life Insurance Company, organized under the laws of Kansas, hereinafter called Federal Reserve, was engaged in the life insurance business in Kansas, Missouri and Indiana; Insurance Investment Corporation, having its principal place of business in Saint Louis, Missouri, was engaged in the business of buying and selling and otherwise dealing in stocks of insurance companies; and the Reserve Company, with its principal place of business in Kansas City, Missouri, was likewise engaged in the business of buying and selling and otherwise dealing in stocks of insurance companies. In 1929, Federal Reserve had outstanding 30,000 shares of capital stock of the par value of $10.00 each, of which Insurance Investment Corporation and the Reserve Company owned 5683 and 8800 shares, respectively. During that year the Insurance Commissioner of Kansas examined the affairs of Federal Reserve and made a report in which its financial condition was criticized and an impairment of capital and reserves was asserted. To meet that situation, Insurance Investment Corporation made an agreement with Fire Insurance Company of Chicago to advance to Federal Reserve, on behalf of Fire Insurance Company, $300,000 and to take therefor a participating certificate, and to sell to Fire Insurance

Company a majority of the outstanding shares of stock of the Federal Reserve. Pursuant to such agreement, Insurance Investment Corporation, on November 18, 1929, advanced to Federal Reserve $300,000 and received therefor the participating certificate which contained these provisions:

> " 'For Value Received, The Federal Reserve Life Insurance Company, a Kansas Corporation (hereinafter called the "Company"), hereby promises to pay to Insurance Investment Corporation, a Delaware corporation, or its assigns, the sum of Three Hundred Thousand Dollars ($300,000.00), together with interest thereon from the date hereof at the rate of six per cent (6%) per annum, payable semi-annually, out of a fund to be created by the company setting aside semi-annually on the 30th day of June and the 31st day of December, all net surplus gains in excess of Fifty Thousand Dollars ($50,000.00) until all principal and interest due under this obligation is fully paid. Net surplus gains in excess of Fifty Thousand Dollars ($50,000.00) shall mean that if at any time the Company has a net free surplus of Fifty Thousand Dollars ($50,000.00) that all moneys in excess of that sum shall be paid into the fund above specified.
>
> " 'The obligation of the Company hereunder is a contingent liability, not an absolute promise to pay, but is limited to its firm obligation and covenant to apply the said surplus gains to the making of the payments herein provided for and is not an obligation to be paid out of the general assets of the Company other than the fund mentioned in this certificate.
>
> " 'In the event of a reinsurance of the business of The Federal Reserve Life Insurance Company the reinsuring company shall be bound each six (6) months to pay the savings and profits arising out of the reinsured business (less such part of such savings and profits as may be payable under prior contracts to other persons or c rporations) to the then holder or holders of this certificate or any certificate or certifi-

cates issued in lieu of this certificate until the full balance of interest and principal due thereon shall have been paid.'

"On the same day, and for a valuable consideration, Insurance Investment Corporation assigned and delivered such certificate to Fire Insurance Company, and also assigned and delivered or caused to be assigned and delivered, to Fire Insurance Company, 15,100 shares of the capital stock of Federal Reserve, including its own shares and those held by the Reserve Company. Claimant subsequently acquired and owns the certificate, on which no part of the principal or interest has been paid.

"In 1935, a stockholder and policyholder of Federal Reserve instituted this proceeding in equity in the United States Court for Kansas and prayed for the appointment of a liquidating receiver. The receiver and Occidental Life Insurance Company, hereinafter called Occidental, entered into a contract dated June 13, 1936, which provided, among other things, that subject to the terms and conditions therein specified, and not otherwise, Occidental should reinsure and assume the liability of Federal Reserve under its contracts of insurance which were in force and effect on May 22; that coincident with the approval of the contract, title to all of the assets of Federal Reserve should vest in Occidental; that since such assets at their then value were insufficient in amount to cover the reserve liabilities, a lien of fifty per cent of the net equity should be placed against each policy thus reinsured, with provision that the lien should be adjusted at the times and in the manner therein specified, but in no event should it exceed fifty per cent of such net equity; that all assets conveyed, together with all net gains and profits from the business reinsured and from the assets administered by Occidental, should be covered into a separate fund called Federal Reserve Fund; that such fund should be kept in a

separate bank account or accounts and that no investment should be acquired with such fund except with the consent and approval of the court; and that Occidental should furnish the court an annual accounting of such fund as long as the lien should exist against the policies, but in no event after June 30, 1951. At no time subsequent to the execution and delivery of the certificate did the books and records of Federal Reserve, or reports or statements published or filed with the insurance department of any state in which it was licensed to do business show or include such certificate as a liability. Occidental had knowledge at the time of the execution of the contract of the existence of such certificate and of claimant's asserted ownership of it. [The decree and reinsurance contract are set out at R. pp. 33-61.] The court approved the contract and authorized its consummation. Occidental assumed its liability under the contracts of insurance; the receiver transferred, conveyed and delivered the assets to Occidental; the special fund was created; and the contract has been carried out according to its terms. With the money advanced by Insurance Investment Corporation, in the manner outlined, Federal Reserve purchased from a bank a certificate of deposit which was deposited with the Commissioner of Insurance of Indiana as a part of its reserve supporting its outstanding policies of insurance in that state. A substantial part of the money was subsequently loaned, the notes and mortgages received therefor were deposited with the Commissioner of Insurance of Indiana, and they subsequently became a part of Federal Reserve Fund. On May 22, 1936, the total amount of required reserve on all policies issued or assumed by Federal Reserve exceeded $7,500,000, and according to an appraisement made after the approval of the contract, the value of all its assets as of that date was $5,115,738.68. The lien imposed against the net equities of the policies assumed by Occidental, as of such date, amounted to $2,718,120.72; after the applica-

tion of such lien, the surplus funds amounted to $172,511.67; by order of the court surplus, or such part of it as might be necessary, was reserved for the payment of receivership expenses; and the expenses of the receivership to December 31, 1938, amounting to $157,896.55, were paid by the receiver with funds furnished to him from the Federal Reserve Fund.

"Claimant pleaded upon information and belief that profits arising out of the reinsured business of Federal Reserve in excess of $200,000 had accrued and that profits were constantly and continuously accruing; and it prayed that it be adjudged entitled to a lien upon all such profits superior to that of the policyholders or other parties to the suit. The court disallowed the claim and the appeal is from that judgment."

To this we add that the reinsuring company assumed no obligation under the reinsurance contract to pay moneys out of its own funds, the contract providing that the reinsuring company, the Occidental Life Insurance Company, should be reimbursed out of the Federal Reserve fund for any moneys paid on account of the business reinsured which was properly chargeable to that fund (R. pp. 51-2).

The reinsurance contract also provided that the savings and profits of the reinsured business should be applied annually to the reduction of the lien placed by the decree of the Court and the reinsurance contract on the policies constituting the reinsured business until June 30, 1951. After that date the reinsured business becomes completely merged in that of the reinsurer and the requirement as to the maintenance of a separate fund is discontinued (R. p. 52).

The Court held invalid the contract provision that the savings and profits of the reinsured business should be applied to the repayment of the $300,000.00 advanced as

provided in the participating certificate, and upheld the decree of the lower court to the effect that such savings and profits for a stated period should be applied for the benefit of policyholders of the Federal Reserve and thereafter for the benefit of the Occidental Life Insurance Company resulting in the total exclusion of any claim on the part of the holder of the certificate to repayment of the money advanced.

The judgment denying the claim of the International Company of St. Louis was rendered by the District Court of the United States for the District of Kansas on the 28th day of June, 1939 (R. pp. 174-176).

On the 12th day of July, 1940, after due submission to the United States Circuit Court of Appeals for the Tenth Circuit, said Court rendered its opinion and judgment upon the petitioner's said appeal (R. p. 189), affirming the said judgment and decision of the said District Court.

Thereafter, on the 5th day of August, 1940, petitioner duly filed its petition for rehearing in said cause in said Circuit Court of Appeals (R. p. 202). Said petition for rehearing was denied on the 19th day of August, 1940 (R. p. 202).

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

I.

The decision of the Circuit Court of Appeals for the Tenth Circuit denying the petitioner's claim for repayment of $300,000.00 advanced to The Federal Reserve Life Insurance Company is based primarily upon the proposition that under the terms of the certificate providing for repayment of the money advanced the payee or holder thereof occupies a position analogous to a stockholder and is,

therefore, not entitled to the benefit of the security provided for in the certificate to the prejudice of the claims of creditors of the corporation. The question as to the proper test for determining whether a person advancing money to a corporation is a creditor or is entitled only to the rights of a stockholder is an important question of general law which has not been, but should be, settled by this Court.

A. In the case of Warren v. King, 108 U. S. 389, decided by this Court in 1883, it was held that a holder of preferred stock in a corporation is not a creditor and is not entitled to the benefit of the security provided for in his stock certificate to the detriment of creditors. However, the Court did not in that opinion, except by inference, announce any test or rule for determining the question as to whether or not any particular contribution of money to a corporation constitutes the person advancing the money a creditor or a stockholder. This question has arisen in numerous cases under the income tax law in determining whether or not money paid by the taxpayer was dividends or interest. It has arisen in bankruptcy proceedings, where payments have been made by the bankrupt to a preferred stockholder on the theory that he was a creditor. It has also arisen in cases like the one under consideration here in determining the question as to whether or not a person advancing money to a corporation is a creditor and therefore entitled to the benefit of the security provided in his contract or a stockholder and therefore not entitled to the benefit of such security. The proper rule for determining this question has not been, but should be, settled by this Court.

B. In the case of Warren v. King, 108 U. S. 389, this Court, in holding that the owner of a certificate of preferred stock was not entitled as against creditors to the

benefit of the security provided in his stock certificate, assigned as reason (108 U. S., p. 399) the following:

> "His chance of gain, by the operation of the corporation, throws on him, as respects creditors, the entire risk of the loss of his share of the capital, which must go to satisfy the creditors in case of misfortune."

As a matter of necessary inference from this holding, it would follow that a person who merely advances money to a corporation under a contract which gives him no chance of gain from the operation of the corporation and only provides for the repayment of the money advanced with interest at the lawful rate specified is not in the position of a stockholder and is entitled to the benefit of whatever security his contract provides. The participating certificate set forth, supra (R. p. 22), provides for the payee no chance of gain from the operation of the corporation and only repayment of the money advanced with lawful interest. Therefore, the Court of Appeals, in holding that the payee or holder of the certificate occupies a position analogous to a stockholder, rendered a decision in conflict with the principle laid down by this Court in Warren v. King, 108 U. S. 389, and also in conflict with the decisions of various courts of appeals which have cited and followed the case of Warren v. King, as follows:

Hamlin v. Toledo, St. L. & K. C. R. Co., 78 F. 664 (C. C. A. 6);
Helvering, Commr. of Internal Revenue, v. Richmond F. & P. R. Co., 90 F. (2d) 971 (C. C. A. 4);
Commissioner of Internal Revenue v. O. P. P. Holding Corp., 76 F. (2d) 11, 12 (C. C. A. 2);
Isaacs v. Neece, 75 F. (2d) 566, 568 (C. C. A. 5);
In Re Lathrap, 61 F. (2d) 37.

II.

In the case of any new insurance company the cost of getting business for a time exceeds the premiums received from the holders of policies. Neither the capital stock nor the reserve fund set aside for the benefit of policyholders can be encroached upon for the purpose of paying these expenses of getting new business and, if the reserve is so encroached upon, it must be restored. Otherwise the company is deemed insolvent. In this case the corporation had thirty-two million dollars of insurance in force and more than twenty-seven thousand policyholders (R. p. 169). It had a right to pledge the future earnings or savings and profits of that business for the purpose of restoring an impairment in its reserve or to secure money to carry on the business. The validity of such pledges has been recognized by a number of courts in various cases, but has never been passed on by this Court. The question of the validity of such contracts is an important question of general law which should be settled by this Court. The validity of such contracts was upheld in:

Kingston v. Home Life Ins. Co. of America (Del.), 101 Atl. 898, 11 Del. Chancery Reports 258, affirmed 104 Atl. 25, 11 Del. Chancery Reports 428;

General American Life Ins. Co. v. Roach (Okla.), 65 Pac. (2d) 458, 179 Okla. 301;

Sherman v. International Life Ins. Co., 236 S. W. 634, 291 Mo. 139;

Jacobs v. Wisconsin National Bank (Wis.), 156 N. W. 159, 162 Wis. 318.

III.

The opinion of the court below establishes an unjust and inequitable result in that it denies to the payee of this certificate the right to recover $300,000.00 which was in good faith paid to the insurance company and applied by it in

restoring its impaired reserve for the benefit of policyholders, although the recovery is sought by this claimant not out of the reserve, not out of general assets, but merely out of savings and profits of the reinsured business which, under the contract with the Federal Reserve were to be applied to the repayment of this money. It is not equitable for the policyholders of the Federal Reserve to receive the benefit of this $300,000.00 and after insolvency also receive the benefit of the security which was pledged for its repayment, to wit, the savings and profits of the reinsured business as administered by the reinsuring company.

IV.

One does not become a stockholder merely because his contribution to the corporation is payable out of future earnings.

Ketchum v. St. Louis, 101 U. S. 306;
Stone v. Wright, 75 F. (2d) 457 (C. C. A. 10).

PRAYER.

For the purpose of correcting the errors complained of and to the end that the rights of the petitioner may be determined in accordance with the law, your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding it to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the records and proceedings of the said Circuit Court of Appeals in the within described cause of International Company of St. Louis, a corporation, appellant, v. E. R. Sloan, Receiver of The Federal Reserve Life Insurance Company, a corporation, and Occidental Life Insurance Company, a corporation, appellees, No. 2006, in equity, to the end that

the judgment of said Circuit Court of Appeals in said cause may be reviewed by this Court as provided by law, and that your petitioner may have such other relief as to this Court may seem appropriate, and that the judgment of the said Circuit Court of Appeals may be reviewed by this Honorable Court.

INTERNATIONAL COMPANY OF ST. LOUIS,
Petitioner,

By WILLIAM L. MASON,
Counsel for Petitioner.

SUPPORTING BRIEF.

I.

OPINIONS OF THE COURTS BELOW.

The findings of fact and conclusions of law and decree of the said District Court below appear at pages 161-173, inclusive, of the record and are not reported.

The opinion of the said Circuit Court of Appeals (R. p. 182) is not as yet reported.

II.

JURISDICTION OF THIS COURT.

1.

Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U. S. C. A., Sec. 347).

2.

The following decisions sustain the jurisdiction of this Court to review the decision of the Circuit Court of Appeals for the reasons set out in the specifications of error:

Warner v. New Orleans, 167 U. S. 467;
Ivanhoe Building & Loan Association of Newark v. Orr, 295 U. S. 243;
Erie Railroad Company v. Tompkins, 302 U. S. 671, reported 304 U. S. 64.

III.

Inasmuch as the payee of the certificate sued on was not entitled under the terms of the contract, under any cir-

cumstances, to profit or gain and as the contract provides for a definite time of payment (though dependent on a contingency), there is no basis for the holding of the court below that the payee of the certificate occupies a position analogous to that of a stockholder.

See authorities cited supra under Point I of Reasons for Allowance of Writ, p. 12.

IV.

A pledge by an insurance company of future savings and profits of its insurance business for a proper corporate purpose is a valid pledge.

See authorities cited under Point II, supra, p. 13.

V.

One does not become a stockholder in a corporation merely because he advances money under a contract which provides that it is payable out of future earnings and profits.

See authorities cited under Point IV, supra, p. 14.

VI.

The original date of the judgment of said Circuit Court of Appeals, here sought to be reviewed, is July 12, 1940 (R. p. 189). Petitioner's petition for rehearing was duly filed in said Circuit Court of Appeals on August 5, 1940 (R. p. 202), and was overruled on August 19, 1940 (R. p. 202).

VII.

STATEMENT.

A full statement of the case has been made in the petition for writ of certiorari, and, in the interest of brevity, the statement is not here repeated.

VIII.

SPECIFICATIONS OF ERROR.

A.

The Circuit Court of Appeals for the Tenth Circuit erred in deciding and adjudging that the petitioner's status as holder of the participating certificate or written agreement for the repayment of the $300,000.00, set out at record page 22, is analogous to that of a preferred stockholder, and in holding that for such reason the petitioner is not a creditor and not entitled to repayment of the money advanced out of savings and profits realized by the reinsurer, the Occidental Life Insurance Company, out of the reinsured business of The Federal Reserve Life Insurance Company.

B.

The Circuit Court of Appeals for the Tenth Circuit erred in deciding and adjudging that the provision in the said participating certificate that "in the event of a reinsurance of the business of The Federal Reserve Life Insurance Company the reinsuring company shall be bound each six months to pay the savings and profits arising out of the reinsured business * * * to the then holder or holders of this certificate," had reference only to a voluntary reinsurance of the business and not to reinsurance of the business in connection with the transfer and conveyance of the assets of the Federal Reserve in judicial proceedings.

C.

The Circuit Court of Appeals for the Tenth Circuit erred in deciding and adjudging that the sale and transfer of the assets of The Federal Reserve Life Insurance Company under order of the Court in receivership proceedings was

equivalent in law to a foreclosure of the paramount lien or interest of the policyholders and that the right of the claimant was analogous to that of a preferred stockholder and that such foreclosure extinguished any claim on its part to the gains and profits thereafter accruing to the business under the ownership and operation of the Occidental Life Insurance Company.

IX.

ARGUMENT.

POINT I.

(Assignment of Error A.)

As to the Proposition That the Holder of the Certificate Occupies a Position Analogous to That of a Preferred Stockholder.

We respectfully submit that the Court is in error in holding that the relationship between the owner of the certificate and the policyholders and other creditors is substantially analogous to that ordinarily existing between a preferred stockholder and creditors. In this case the Fire Insurance Company of Chicago, at the time it entered into the agreement with the Insurance Investment Company to advance the $300,000.00 evidenced by the certificate, was not a stockholder and, if the written contract under which it advanced the money is clear and unambiguous, its rights should not be determined by the motives which may have influenced the borrowing company and the Insurance Investment Company, which was the owner of part of its stock. The instrument itself is simply a promise to pay the $300,000.00 advanced with 6 per cent interest, with the further provision that the Federal Reserve was not bound by an absolute promise but only under a contingent liability to pay out of a fund to be set aside semiannually, made

up of net surplus gains in excess of $50,000.00. The certificate undertakes to fix a different liability upon the reinsuring company in the event of a reinsurance of the business of the Federal Reserve. In that case it provides:

> "The reinsuring company shall be bound each six months to pay the savings and profits arising out of the reinsured business * * * to the then holder or holders of this certificate * * * until the full balance of interest and principal due thereon shall have been paid."

There is an obvious difference between "net surplus gains" of the company, out of which the original obligor was bound to pay, and "savings and profits" of the reinsured business, out of which the reinsurer was bound to pay. Savings and profits of an insurance business are made up of mortality savings, cash surrender charges, and profits from lapses (R. pp. 144-5). Such savings and profits might exist in case of a certain group of policyholders, even though the reinsuring company carrying on the business might not realize any net surplus gains. But, however the contract embodied in the certificate may be viewed, we submit that there is nothing in it which justifies the conclusion that the rights of the holder of the certificate are analogous to the rights of a preferred stockholder.

The right of a stockholder, either common or preferred, is to receive repayment of his contribution to the corporation only after all creditors of the corporation have been entirely satisfied. The reason underlying this is that the stockholder is identified with the corporation itself as owner and manager. He is not limited simply to the repayment of his investment with interest, but may receive dividends on his investment measured only by the life and success of the corporation, with the possibility, on liquidation of the assets, of receiving back his entire investment, or possibly more.

Under the terms of the certificate here under consideration the holder of the certificate differs from a stockholder in this:

1. He could never, under any circumstances, receive back more than the money advanced, together with interest at the prescribed rate, which in this case was 6 per cent.

2. There is nothing in this certificate which gives the holder or owner of it any proprietary rights in the corporation whatsoever or any voice in its management.

We submit that no case will be found in the books, and none has been cited in the opinion of the court below, where it is held that a person becomes a stockholder, either common or preferred, who merely lends money to a corporation without any prospect of gain except to receive back his money with interest and without any right of management or in the final distribution of the assets such as appertain to a stockholder of a corporation.

The leading and original authority on this subject, which is cited and relied on both in Hamlin v. Toledo, St. L. & K. C. R. Co., 78 F. 664, and In Re Lathrap, 61 F. (2d) 37, cases cited in the opinion of the Court of Appeals, is the case of Warren v. King, 108 U. S. 389. In that case it appeared that in one of the reorganizations of a railroad company certain persons who had theretofore occupied the position of creditors accepted preferred stock. These certificates of preferred stock provided, among other things, that:

> "The preferred stock is to be and remain a first claim on the property of the company after its indebtedness and the holders thereof shall be entitled to receive from the net earnings of the company 7 per cent per annum, payable semi-annually. * * *"

It further appeared from the certificate that payments to preferred stockholders were not limited to any particular

period, nor was the right of the holder of the preferred stock limited to a return of the amount of the indebtedness for which the preferred stock was substituted. It was contended by the holder of the preferred stock that it was entitled to the benefit of a lien on all the assets of the company existing at the time the preferred stock was issued, subject only to certain indebtedness then existing, and that this lien was superior to the claims of subsequent creditors. It was held that such preferred stockholder had no priority over subsequent creditors by virtue of the lien sought to be set up by the certificate. The reason underlying the Court's decision is set out in the opinion at page 399 as follows:

> "There is nothing in the certificate which clothes them with a single attribute of a creditor, while it specially gives them, as stockholders, equal interest with the common stockholders in the excess of net earnings in one year after paying therefrom 7 per cent on each share of stock, preferred and common.
>
> "Whatever position the holders of preferred certificates occupied before they accepted preferred stock, whatever special rights of lien they had, they became corporators, proprietors, shareholders, and abandoned the position of creditors, and took up towards existing and future creditors the same position which every stockholder in a corporation occupies towards existing and future creditors. **His chance of gain, by the operations of the corporation, throws on him, as respects creditors, the entire risk of the loss of his share of the capital, which must go to satisfy the creditors in case of misfortune.** He cannot be both creditor and debtor, by virtue of his ownership of stock. In this case, all the parties holding trustees' certificates united to form a new corporation, converted themselves into stockholders in it.
>
> "It must be clear that, if the trustees, representing the holders of trustees' certificates, had gone on and operated the road for them, not organizing a new com-

pany, any debts contracted by the trustees in the business would have had priority over the claim of the holders of such certificates. So, in becoming stockholders in the new company, with the right to vote as to its management and to share in its earnings, they must have intended to allow, through the corporation, a priority of debts over their claims as stockholders." (Emphasis ours.)

The case of Hamlin v. Toledo, St. L. & K. C. R. Co., 78 F. 664, cited by the court below in support of its conclusion that appellant occupies a position analogous to that of a stockholder, is a well-considered opinion of the Sixth Circuit written by Judge Lurton and participated in by Judge Taft. Here again, as in the Warren case, it appears that certain intervenors in a receivership proceeding were holders of preferred stock. The certificates designated the holdings as preferred stock and undertook to provide that the stock should carry a lien on the profits and net earnings of the company, subject only to a first mortgage, and that the company would create no lien on its profits other than the first mortgage except subject to the lien of the certificates. The holders of this preferred stock undertook to enforce this lien as against subsequent creditors. The certificate is set out on page 668 of the opinion. It was held by the Court that this attempt to create a lien as against creditors subsequent to the first mortgage creditors was void and that the holders of this preferred stock took subject to the rights of all creditors. The reason underlying the decision of the Court is set forth at pages 670-671 of the opinion as follows:

"There is a wide difference between the relation of a creditor and a stockholder to the corporate property. One cannot well be a creditor as respects creditors' property and a stockholder by virtue of a certificate evidencing his contribution to the capital of the corporation. Stock is capital, and a stock certificate but

evidences that the holder has ventured his means as a part of the capital. It is a fixed characteristic of capital stock that no part of it can be withdrawn for the purpose of reimbursing the principal of the capital stock until the debts of the corporation are paid. These principles are elementary. Warren v. King, 108 U. S. 389, 2 Sup. Ct. 789; Cook, Stock, Stockh. & Corp. Law (3rd Ed.), Section 771. **The chance of gain throws on the stockholder, as respects creditors, the entire risk of his contribution to capital.** 'He cannot be a creditor and debtor by virtue of his ownership of stock.' Warren v. King, supra. If the purpose in providing for these peculiar shares was to arrange matters so that, under any circumstances, a part of the principal of the stock might be withdrawn before the full discharge of all corporate debts, the device would be contrary to the nature of capital stock, opposed to public policy, and void as to creditors affected thereby. Cook, Stock, Stockh. & Corp. Law (2d Ed.), Sections 270, 271; Chaffee v. Railroad Co., 55 Vt. 110; McCutcheon v. Capsule Co., 19 C. C. A. 108-115, 71 Fed, 787; Morrow v. Steel Co., 87 Tenn. 262, 108 S. W. 495. If that was the purpose of this arrangement, most doubtful language was employed. There is a sense in which every shareholder is a creditor of the corporation to the extent of his contribution to the capital stock. In that sense, every corporation includes its capital stock among its liabilities. But that creditor relation is where it exists only between the corporation and its shareholders. It is a liability which is postponed to every other liability, and no part of the capital stock can be lawfully returned to the stockholders until all debts are paid or provided for. The violation of this well-understood principle is a breach of trust, and a corporation affected thereby may pursue the stockholders and recover as for an unlawful diversion of assets." (Emphasis ours.)

The other case cited by the court below upon the proposition here under consideration is In Re Lathrap, 61 Fed. (2d) 37. This case differs from the others cited in that it

was not, like the case at bar, a proceeding in equity wherein it was sought to establish an equitable lien. It was a bankruptcy proceeding. The bankrupt, by written assignment, had undertaken to assign to Rose W. Lamberton and others a royalty interest equivalent to a certain percentage of the gross proceeds received from the sale of 100 per cent of the oil and gas produced in certain wells in process of being sunk. The case discusses various questions with reference to the purchase of and transferring title to oil and gas in the ground and applicable California statutes which are entirely foreign to the question under consideration here. However, the Court also held that the purchaser of such an interest was a co-adventurer in the business. It will be observed that the holders of these certificates were not limited to a repayment of their money as a loan with interest. The profits were limited only by the productive capacity of the well. On this phase of the case the Court, again relying on the fundamental principles laid down by the Supreme Court of the United States in Warren v. King, supra, at pages 43-44 of the opinion said:

> "Although per cent holders are a recent product of corporate finance, and therefore, in a sense sui generis, they bear a close analogy to preferred stockholders. As to the rights and risks of the latter, the Supreme Court has this to say, in Warren and Others v. King and Others, 108 U. S. 389, 399, 2 S. Ct. 789: 'Whatever position the holders of preferred certificates occupied before they accepted preferred stock, whatever special rights of lien they had, they became corporators, proprietors, shareholders, and abandoned the position of creditors, and took up towards existing and future creditors the same position which every stockholder in a corporation occupies towards existing and future creditors. **His chance of gain, by the operation of the corporation, throws on him, as respects creditors,** the entire risk of the loss of his share of the capital, which

must go to satisfy the creditors in case of misfortune. He cannot be both creditor and debtor, by virtue of his ownership of stock.

"So in the instant case. Whether or not the per cent holders come under the technical classification of stockholders, they are—like stockholders, partners or joint adventurers—'investors' participants in the common enterprise. Had the bankrupt prospered and continued the operation of the oil well, these per cent holders would have prospered with him, **to an extent that their certificates did not even attempt to limit.** Conversely, these same holders must be prepared to share in the bankrupt's misfortunes. There is no equity in their favor that places them in a position equal to that of general creditors, who sold merchandise or labor at only a nominal profit. The creditors should not be the first to be sacrificed. It is the 'investors' who should be ready to take the bitter with the sweet."

We submit that the difference between rights of the holder of the certificate under consideration here and the rights of stockholders is fundamental and is clearly pointed out in the above cases cited in the Court's opinion. This certificate did create an equity in favor of the holder superior to that of general creditors. The payee of the certificate was a creditor only in that it gave the holder no right of proprietorship or ownership of the corporation making the promise—no rights except to receive back the money with interest.

We submit that none of the cases cited is authority for the proposition that the certificate creates a relationship analogous to that of a stockholder of preferred stock merely because the money was payable by the company out of any particular fund, however designated. It is the opportunity for unlimited gain which constitutes the difference between a stockholder and a creditor, and not the fund out of which the money advanced is payable.

The Court, in arriving at its conclusion that this $300,000.00 was merely a contribution to capital and that the certificate conferred only stockholder's rights, lays emphasis upon the fact that the capital was impaired and that it was necessary to restore it. This was all true from the standpoint of the debtor corporation and its stockholders, but the motive which influenced the borrower, that is, the motive to replenish its capital, and the fact that it used the money for that purpose, can not make the lender, the Fire Insurance Company of Chicago, a stockholder simply because that was the purpose of seeking the loan. The certificate gives the Fire Insurance Company of Chicago, or any holder thereof, only the rights of a lender, limited to the repayment of the moneys advanced, with interest, out of a certain fund, but no rights of proprietorship in the company whatever. The fact, therefore, that the borrower may have used the money to replenish its capital and that the lender may have known that was the purpose of contracting the debt, cannot make the lender a stockholder.

Furthermore, the Court places emphasis upon the fact that the Federal Reserve, in keeping its accounts, never carried this $300,000.00 as a liability. We submit that is no part of the background or circumstances accompanying the loan which should be considered in determining the meaning of the certificate, even if its meaning were doubtful. The borrower cannot affect the rights of the lender by the manner in which he keeps his books or makes his reports to any supervising authority. There is no evidence in the record that the Fire Insurance Company of Chicago or any holder of this certificate had any participation in this sort of bookkeeping or even any knowledge as to how this liability was carried on the books or whether it was noted on the books at all. Furthermore, such knowledge on the part of the creditor or holder of the certificate, if it existed, could not affect the rights created by the certifi-

cate which designates the liability as a contingent liability payable under the circumstances therein set forth.

The opinion of the Court below in the case at bar is contrary to the principles laid down by the Supreme Court of the United States in the case of Ketchum v. St. Louis, 101 U. S. 306, as well as those laid down by the Court below in the case of Stone v. Wright, 75 F. (2d) 457. The situation in each of these cases is analogous in that, in both, the money advanced was payable out of earnings or profits. However, a definite sum was payable, that is the money advanced with interest in the Ketchum case and simply the money advanced in the Wright case. This was the feature which placed the claimant of an equitable lien in each of these cases in the position of a lender or creditor and not a stockholder. The situation is the same here, and in denying the appellant the relief sought the Court below reaches a conclusion directly contrary to that before announced by the Supreme Court and by the Court below in the cases last above cited.

B.

As to the Proposition That the Certificate in Undertaking to Fix the Liability of a Reinsuring Company Had Reference Only to Voluntary Reinsurance.

We respectfully submit that the Court below was in error in holding that the parties to the contract embraced in the certificate contemplated only a voluntary reinsurance and had no reference to reinsurance in connection with receivership proceedings. The language of the certificate itself shows that it contemplated the reinsurance of the business by another company than the original obligor. This obligation is to arise "in the event of a reinsurance of the business of The Federal Reserve Life Insurance Company." This language, in its natural scope and meaning, covers any reinsurance, whether voluntary or involuntary. We

submit that there is nothing in the circumstances to indicate that the parties had any purpose to restrict the natural scope and meaning of the words used so as to cover only voluntary reinsurance. Indeed, the circumstances—if it is necessary to look into the circumstances in order to arrive at the meaning of the language, which is plain in itself—indicate that in making this provision the lender of the money was seeking to protect itself against involuntary reinsurance in receivership proceedings. The parties very well knew that there are two kinds of reinsurance, both dependent for their validity on the consent of the policyholders reinsured; one, a reinsurance, voluntary in character, arising solely out of contract between the original company and the reinsurer with the consent of the policyholders, and the other a reinsurance in receivership proceedings independent of the consent of the original company but also dependent for its validity on the consent of the policyholders. The parties must have known that, in case of insolvency, reinsurance is the usual method of protecting the interest of the policyholders. They must have known that in such event the policyholders had a right to take down their share of the assets or to accept the proposed reinsurance arrangement. They must have known that it would be greatly to the interest of the policyholders to accept any reasonable reinsurance arrangement and that, in the ordinary course of events, the great majority of the policyholders would do so, as they did in this case. In arriving at this conclusion, we submit that the Court below leaves out of consideration this important fact, to wit, that notwithstanding the fact that the capital was impaired at the time this money was advanced and the reserve was impaired, the lender, by separate transaction contemporaneous with the lending of the money and for a separate consideration, acquired the ownership of a majority of the stock of The Federal Reserve Life Insurance Company. (See statement supra, p. 7.) With the com-

pany in the condition that it was at that time, this stock in and of itself could not have been a very attractive investment. At least one natural reason for acquiring that stock was that the lender might be able, through a majority stock control of the company, to protect its contingent obligation in case of any voluntary reinsurance contract entered into by the company. It was not necessary for the certificate itself to provide for protection in case of voluntary reinsurance because the lender itself had control of that situation. The company being in distress at the time, it was naturally in contemplation of the parties that it might be in trouble again. Therefore, this provision as to what the rights of the holder of the certificate should be in the event of any reinsurance was placed in the certificate for the obvious purpose of protecting the lender against a reinsurance in court proceedings, which the majority stockholder could not control.

We submit that for the Court to hold that the lender in entering into such an agreement had reference only to a voluntary reinsurance is to assume that the lender was wanting in ordinary intelligence and understanding of the situation and in the ordinary instinct of self-preservation. If it were legal to provide that, in the event of a reinsurance through court proceedings, the lender of the money covered by this certificate should have the rights provided for in the certificate, then it is not reasonable to suppose that the parties did not intend to give the lender all the protection that the circumstances permitted.

We submit that there is nothing in the circumstances whatever to show that they had any other intention. It is a well-recognized fact, as appears from the record, that a given volume of insurance in force has a value as a source of profits and income separate and apart from the assets which constitute the reserve. The reserve is a trust fund set aside solely for the benefit of policyholders, but the policyholders have no interest in any other assets of

the company, either actual or potential, which prevents the company in the course of its ordinary business from borrowing money on the security of such other assets. It did borrow money in this case on the security indicated. The policyholders were given the benefit of it. It is not sought now to take away from the policyholders one cent of the $300,000.00 which was placed in the reserve fund for their sole benefit. The effect of the decree is to deny to this claimant the sole security given to it as a contingent creditor for the money advanced. The policyholders had no interest in the savings and profits in this business until after the insolvency and until after the reinsurance contract approved by the decree of the Court below gave the policyholders an interest in those savings and profits. We submit that the Court below had no right to do that except subject to the valid lien on such possible savings and profits which had theretofore been created for the purpose and with the result of contributing $300,000.00 to the fund in which the policyholders were solely interested.

C.

As to Foreclosure of Lien by Sale and Transfer of the Assets.

The Court below held that:

> "The sale and transfer of the assets under order of the Court in the receivership proceeding was equivalent in law to a foreclosure of the paramount lien or interest of the policyholders. Since the only right which claimant had was analogous or akin to that of a preferred stockholder, such foreclosure extinguished any claim on its part to the gains and profits thereafter accruing to the business under the ownership and operation of Occidental."

Of course, it is true that, if the rights of the claimant are analogous or akin to those of a preferred stockholder,

then, inasmuch as the company was confessedly insolvent, the claimant has no right to any reimbursement. On the authority of the cases above referred to and cited in the opinion of the Court below, we submit that claimant is in the position, not of a preferred stockholder, but of a creditor. It simply loaned this money with no hope of gain except repayment of the money itself with lawful interest. It has never been held that such a person was a stockholder, co-adventurer, or joint proprietor, or that he occupies any other position than that of creditor with a claim payable upon the contingency indicated in the contract.

The sale and transfer of the assets, it is true, cut off all rights, both of policyholders and of all other persons, in those assets except to the extent provided in the reinsurance contract. The policyholder had the right to take his share of the assets. When he elected not to do that, he took only under the reinsurance contract and subject to the rights and restrictions contained in that contract. The reinsurance contract itself provides that the Occidental should have the right to reimburse itself for any moneys paid out which were properly a charge against the Federal Reserve fund (R. pp. 51-52). Under the reinsurance contract, the Federal Reserve fund included not only the tangible assets constituting the reserve fund but also the savings and profits from the reinsured business itself, that is, such savings and profits as might result from mortality savings, cash surrenders and other fees which an insurance company ordinarily looks to as a source of profit. This claimant has a lien in every sense equitable and just on such profits. Therefore, when the policyholders accepted this reinsurance agreement with full knowledge, through the Receiver, of the existence of this claim, they consented to whatever rights might arise out of the situation and the reinsurance contract in favor of the holder of this certificate. The paramount lien of policyholders was foreclosed on tangible assets constituting part of the reserve, but the

stockholders had no lien whatever on possible savings or profits of the business which is the subject matter of our claim.

CONCLUSION.

Being desirous of not burdening the Court with an unduly lengthy argument, and having called the Court's attention specifically to the questions involved and to the reasons that exist for the issuance of the writ of certiorari, we will not argue the errors assigned at greater length.

It is respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers by granting a writ of certiorari and thereafter reviewing and reversing the said decision.

Respectfully submitted,

WILLIAM L. MASON,
Counsel for Petitioner.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1940

No. 490

INTERNATIONAL COMPANY OF ST. LOUIS, A CORPORATION,
PETITIONER,

VS.

E. R. SLOAN, RECEIVER OF THE FEDERAL RESERVE LIFE INSURANCE COMPANY, A CORPORATION, AND OCCIDENTAL LIFE INSURANCE COMPANY, A CORPORATION.

BRIEF ON BEHALF OF E. R. SLOAN, RECEIVER OF THE FEDERAL RESERVE LIFE INSURANCE COMPANY IN RESISTANCE TO PETITION FOR WRIT OF CERTIORARI.

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STATEMENT

As the essential facts appear in the opinion of the Circuit Court of Appeals, we will not set forth here any detailed statement. It appears to us that the lower court correctly interpreted the rights of the parties under the written instrument upon which the petitioner's claim is based.

The opinion of the lower court in its essence being merely an interpretation of a written instrument in the light of the facts and circumstances surrounding the parties at the time of its issuance, and the instrument being *sui generis,* we can discern in the record no reasonable basis upon which a writ of certiorari might be allowed.

The opinion of the Circuit Court of Appeals discusses and

passes upon three out of a number of grounds for affirming the district court's decision discussed in the briefs filed by appellees in that Court. We will in this brief discuss briefly the three grounds for affirmance decided by the Circuit Court of Appeals. All of them, in our opinion, were correctly decided. Certiorari should, of course, be denied, if the decision of the Circuit Court of Appeals is correct on any one of these grounds.

BRIEF AND ARGUMENT

I.

Whether Its Status Be Described as Like That of a Preferred Stockholder or Otherwise, the Holder of the Participating Certificate Cannot Assert Its Claim in the Liquidating Receivership in Any Manner That Will Prevent the Realization by the Policyholders of the Full Value of the Defunct Corporation's Assets.

It is the policyholders who are most seriously menaced by the assertion of this claim. They are the preferred creditors of The Federal Reserve Life Insurance Company and as such are entitled to have applied towards the partial payment of their claims the full value of the assets of the defunct corporation. If the International's claim be allowed, there will be appropriated to that claimant and taken away from the policyholders a very material portion of the value of the assets of the defunct corporation, which the Court intended should go to the policyholders.

At the time the Receiver was appointed the assets of The Federal Reserve Life Insurance Company were so impaired that their value was equal to only half of the net equities or the then value of policyholders claims. In transferring these assets to the Occidental through the Reinsurance Agreement, to purchase for the Federal Reserve policyholders insurance protection in the Occidental, the Court had included

a provision that the face amount of the Federal Reserve policies should be assumed and paid by the Occidental in case of death of a policyholder during a fifteen year period (R. 43), but that a policyholder could get only half of the net equity of his policy if he elected to cash surrender it or obtain a loan upon it. (R. 50.) In other words, as expressed in the Reinsurance Agreement, the net equities of the policyholders were subject to a fifty per cent lien. The Court, however, made provisions in the Reinsurance Agreement whereby earnings or profits from the Federal Reserve fund as they accrued were to be used in reduction of this lien. (R. 45-46.)

Paragraph 5 of the Stipulated Facts recites that the $300,000.00 paid in by the Insurance Investment Corporation, upon receipt of which the so-called "Participating Certificate" was issued, *"was placed in the surplus account of the Federal Reserve."* (R. 75.)

You cannot build up a surplus by borrowing money. The two terms are contradictory; they are antonyms. The purpose of a call or demand for additional capital or of an addition to surplus is to have the new funds available for the payment of creditors in the event of liquidation.

To make it plain that the holder of the Participating Certificate was not to be a creditor of the Federal Reserve the Participating Certificate contained this recital (R. 75):

> "The obligation of the company hereunder *is a contingent liability, not an absolute promise to pay,* but is limited to its firm obligation and covenant to apply the said surplus gains to the making of the payments herein provided for, and *is not an obligation to be paid out of the general assets of the company* other than the fund mentioned in this certificate."

A stockholder who, to keep a shaky, tottering corporation on its feet, puts new money into the surplus funds of the com-

pany upon the express condition that it will never be returned to him unless the company is able to build up out of future earnings a specified surplus fund, has invested his money in the enterprise subject to the risks and hazards of the business. It seems perfectly obvious that he cannot, when insolvency arrives and forced liquidation becomes necessary, assume the role of a creditor. By whatever name he may be called, his status at best is no better than that of a preferred stockholder who can look only to whatever assets may be left after claims of the true creditors have been paid in full.

The allowance to this certificate holder of a lien upon future profits to be derived from the Federal Reserve assets would diminish the realization and application of the full value of the assets toward the payment of policyholders and other creditors practically to the same extent as though the lien were claimed upon the corpus of the assets instead of upon future profits.

The following quotation from the opinion of the court in *Re Hawkeye Oil Co.,* 19 Fed. (2d) 151 (D.C. Ill.), is peculiarly applicable to the present case:

> "The money to be paid by the company was not to be paid absolutely and at all events, but from a fund arising from the operation of the company. Whether the holders of such contracts are more analogous to stockholders (Fletcher, Cyclopedia Corporations, Par. 3631) than to sleeping partners is, I think, not of such vital importance as the underlying fact, upon which I am in accord with Judge Schoomaker and the referee, that they are not creditors, but are coadventurers with the stockholders, hazarding their investment upon the continued operation, and hence upon the success of the company. The rights of such persons are subordinate to those of general creditors."

In Re Lathrop, 61 Fed. (2d) 37 (9th C.C.A. 1932) cited in the opinion of the Circuit Court of Appeals in the pres-

ent case, an oil lease operator issued and sold certificates which provided that the holders should receive a specified percentage of the oil and gas produced from wells sunk on certain premises. Lathrop, who had issued the certificates was later adjudged a bankrupt; but the claims were disallowed. In the opinion the Court said:

> "So in the instant case. Whether or not the per cent holders come under the technical classification of stockholders, they are, . . . like stockholders, partners or joint adventurers . . . 'investors,' participants in the common enterprise. Had the bankrupt prospered and continued the operation of the oil well, these per cent holders would have prospered with him, to an extent that their certificates did not even attempt to limit. Conversely, these same holders must be prepared to share in the bankrupt's misfortunes. There is no equity in their favor that places them in a position equal to that of general creditors, who sold merchandise or labor at only a normal profit. The creditors should not be first to be sacrificed. It is the 'investors' who should be ready to take the bitter with the sweet."

II.

The Circuit Court of Appeals Correctly Ruled That the Provisions in the Participating Certificate That in the Event of a Reinsurance of the Business of the Federal Reserve the Reinsuring Company Shall be Bound to Pay the Savings and Profits to the Holder of the Certificate Did Not Apply to a Reinsurance Agreement Entered Into by the Receiver After the Federal Reserve Became Insolvent and Ceased to Carry on Its Business.

The International's claim is based solely upon the following provision in the Participating Certificate, all the other terms and provisions of the Certificate being ignored:

> "In the event of a reinsurance of the business of The Federal Reserve Life Insurance Company the re-

> insuring company shall be bound each six months (6) to pay the savings and profits out of the reinsured business . . . to the then holder or holders of this Certificate." (R. 75.)

Whether the parties intended that this reference to "reinsurance" should apply not only to a voluntary reinsurance agreement that might be entered into while the Federal Reserve was solvent and in active business, but also to a Court's use of a reinsurance agreement as a medium for applying the assets to the use and benefit of the policyholders in the event the Federal Reserve should become insolvent, is a question to be determined upon a consideration not merely of this one paragraph in the Participating Certificate but upon a consideration of all the terms and provisions of the instrument. There must also be considered the facts and circumstances that led up to and attended the issuance of the Participating Certificate.

The recitals in the Participating Certificate to the effect that it shall be only a contingent obligation and not an absolute promise to pay and that it shall not be payable out of the general assets of the company show quite plainly that in the event of insolvency the assets of the company were to be disposed of for the benefit of policyholders and other creditors. These provisions clearly mean that freedom of the assets themselves from any liability to be applied towards paying the Participating Certificate included, when the Receiver should dispose of the assets, freedom also of their future income from any liability to be applied to that purpose. Freedom of the assets without freedom of their income, in the event of insolvency, would have been only a hollow pretense. A reading of the Participating Certificate in its entirety clearly shows a major underlying purpose of absolute freedom of the assets from liability on the Participating Certificate, whenever by reason of the condition of the Federal Reserve's affairs

it became necessary to apply its assets towards payment of claims. This major underlying purpose cannot, with any respect for logical reasoning, be held subject to reversal and defeat, if the Receiver's purchaser, instead of paying an all cash consideration for the insolvent's assets bought the assets upon a basis whereby the consideration therefor was a partial reinsurance of the Federal Reserve policyholders, together with an agreement to keep the assets intact and pay earnings or profits over a fifteen-year period.

It must follow that the language of the Certificate as a whole indicates an intention that whenever insolvency overtook the Federal Reserve, the Receiver might dispose of the assets in whatever way would realize the full value for the policyholders—whether by a sale for cash or through a reinsurance agreement. The provisions of the Participating Certificate itself, therefore, show that the reference to "reinsurance" was intended to apply only to voluntary reinsurance agreements that might be entered into by the Federal Reserve itself while it was solvent and in active business.

This conclusion is further supported by the reference in the Participating Certificate to "reinsurance *of the business of the Federal Reserve Life Insurance Company.*" When the company became insolvent and a Receiver was appointed the Federal Reserve ceased to engage in business. The Court enjoined it from doing business. Insolvency breached its insurance contracts. Policyholders became creditors. What the Receiver did was not to "reinsure the business of the Federal Reserve Life Insurance Company," but to use the assets of the defunct company—now the property of the former policyholders of the Federal Reserve—to buy partial reinsurance for them in the Occidental.

It may be sufficient here to call attention to the fact that an official examination of the Federal Reserve's finances had disclosed depleted capital and reserves; that a Committee of

Federal Reserve's directors called upon the Insurance Commissioner and the Attorney General to ascertain what action to better the situation would be required by these officials; that the State officials then assented to a proposal that certain stockholders put $300,000.00 of new money in the company's reserve account and that the company execute in return therefor a document in the form of this Participating Certificate. (See C.C.A. opinion, R. 187.)

Thus the surrounding facts and circumstances show that an involuntary insurance agreement of the Receiver in liquidating assets after the Federal Reserve became insolvent was not such "reinsurance" as is referred to in the Participating Certificate.

There is a close analogy between the reference in the Participating Certificate to "reinsurance" and the covenants in leases and other contracts forbidding assignment. In 16 R.C.L. 834 the rule is thus stated:

> "A general restriction on the right to assign is held to include only a voluntary assignment and not an involuntary assignment."

In a note in 46 A.L.R. 847 the author thus states the rule citing many cases in support thereof:

> "The weight of authority (of recent cases at least) is that a general covenant against assignment of a lease without the lessor's consent is not violated by a transfer in bankruptcy or insolvency proceedings."

One of the leading cases is *Gazley v. Williams,* 210 U.S. 41, 28 Sup. Ct. 687, 22 L. ed. 950. In that case the second syllabus reads:

> "The passage of a lease from the bankrupt to the Trustee is by operation of law and not by the act of the bankrupt nor by sale, and a sale by the Trustee of the bankrupt's interest is not forbidden by, nor is it a

breach of, a covenant for reentry in case of assignment by the lessee or sale of his interest under execution or other legal process, where, as in this case, there is no covenant against transfer by operation of law."

It was clearly intended by all parties when the Participating Certificate was issued that, in the event of insolvency, the full value of the company's assets must be realized for the protection and benefit of the policyholders. The present claimant concedes that the full value could have been realized by a sale for cash, and that if the sale had been made for cash all right of the certificate holder to make claim against the assets themselves, or against the future income therefrom, would have terminated.

We submit that it is wholly illogical to contend that the Receiver had open to him the two methods of distributing the assets, both of them entirely legal and both intended for the protection of the policyholders, but that there was a difference of more than $300,000.00 (the principal of petitioner's claim) in the amount to be realized for the policyholders as between the two methods. The logical conclusion is that stated in the Circuit Court of Appeals' opinion, *i. e.,* that the reference in the Participating Certificate to "reinsurance" was to apply only to such a reinsurance agreement as the Federal Reserve might make while it remained solvent and in business.

III.

The Receiver's Sale in Consideration of a Contract to Reinsure the Policyholders Was the Legal Equivalent of Foreclosure.

The Circuit Court of Appeals correctly ruled that the sale and transfer of the assets under order of the Court in the receivership proceeding was equivalent in law to a fore-

closure of the paramount lien or interest of the policyholders.

When the permanent Receiver was appointed, the Court gave consideration to the question of whether the lien of the policyholders upon the assets could be best protected (1) by the sale of the assets and payment of the proceeds of the sale *pro rata* to the policyholders, or (2) by having the receiver enter into a contract whereby each policyholder would be given an opportunity to have his *pro rata* share of the assets paid to him in cash or applied towards the purchase of new insurance. The second of these plans was found by the Court to be most beneficial to the policyholders. (R. 33-40.) The assets were accordingly transferred to the Occidental as the highest bidder, upon its agreement to pay to each policyholder who elected to take cash his share in the assets of the Federal Reserve, and that the balance of the assets would be used for the benefit of the other policyholders in the purchase of new insurance in the Occidental under the terms of the re-insurance agreement.

When the Federal Reserve policyholders had made their election to take the Occidental insurance or to draw down the cash after the bid of the Occidental had been accepted and after the reinsurance agreement was entered into, a "distribution of the insolvent's estate took place." The legal effect of the transaction was the same as though the Occidental had bid for and purchased the Federal Reserve assets for a sum equal to one-half of the computed value of the net equity of each policyholder and had paid this amount in cash to the receiver plus the net earnings. In view of the Court's order giving each policyholder the right to claim and receive his proportionate share in cash, the Receiver had in legal effect held the entire purchase price awaiting decision by each individual policyholder as to whether he would take down in money his share of the

cash consideration or would permit the Receiver, as his agent to expend it for him in purchasing new insurance protection in the Occidental, *including the right to participate in net earnings of the Federal Reserve Fund up to June* 13, 1951.)

It is true that most of the old Federal Reserve policyholders took this new insurance protection and that only a few of them actually drew down their cash. But each one of the old policyholders had the right to claim his share in cash, so that what was done by the Court through its Receiver was in legal effect a sale and distribution of the insolvent's assets. If every one of the old Federal Reserve policyholders had actually drawn down his share of the cash and had declined the proffered opportunity to have the Receiver reinvest it by purchasing the "new insurance protection" offered by the Occidental, it is clear that the Occidental would have had to pay each one in cash, and there would have been no reinsurance. We would then have had in fact, as we did have in legal effect, the usual liquidation process for an insolvent debtor—that is, a sale of the debtor's assets and a distribution of the proceeds of the sale in payment of dividends.

The disposition of assets of insolvent life insurance companies through reinsurance agreements of this same general character is commonly accepted as a proper and legal method of sale. It has the sanction of the courts.

Through such beneficent methods in handling receiverships of insolvent life insurance companies, the rights of all parties are adequately safeguarded and the life savings of the whole group of policyholders paid in for the protection of their families is saved from the disastrous results that would ensue if disintegration of the enterprise were effected through a complete liquidation.

In *Daniel v. Layton,* 75 Fed. (2d) 175, (7 C.C.A. 1935)

the Illinois Life Insurance Company was adjudged insolvent and a Receiver was appointed therefor. The Receiver, acting pursuant to the orders of the Court, transferred the assets of the defunct company to the Central Life Insurance Company in consideration of the transferee insuring the lives of the policyholders of the insolvent company. Certain non-policyholder creditors objected to the disposition which the Court made of the assets of the insolvent company on the ground that the Court did not sell the assets for cash. The Court held no complaint could be predicated on the objection made, saying:

> "Nor do we see merit in appellants' contention that they are entitled to have the property sold and the affairs of the company liquidated, even though they frustrate the plan of reinsurance and defeat the rights of the policyholders whose claims are perhaps fifty times as great as appellants'. The case of *Coriell v. Morris White Inc.,* (C.C.A.) 54 F. (2d) 255 is authority for the course pursued here. Even in the absence of precedent we think such a plan must meet with judicial approval. The contentions of one creditor must be considered in the light of their effect on other creditors. This, we think, is particularly true in insurance company reorganizations or where the insurance of an insolvent insurance company is reinsured in another company. All that any creditor may legitimately ask is fairness in the distribution of assets. In determining fairness the court may, in cases like the instant one, accept appraisal values instead of resorting to liquidation through sales, etc."

Royal Union Life Insurance Company, v. Gross, 76 Fed. (2d) 219 (8 C.C.A.) lays down the same rule, and in support thereof relies on *Phipps v. Chicago, R. I. & P. Ry. Co.,* 284 Fed. 925, and other cases cited by the Court.

A valid sale and distribution of the Federal Reserve assets having thus been made, the assets—not only the prin-

cipal thereof, but also the future savings and profits to be derived therefrom—have passed beyond the reach of this claimant whose contract by its own terms contemplated that he should not be a creditor and should have no claim upon the assets if the Federal Reserve went into forced liquidation.

CONCLUSION

We respectfully submit that no adequate grounds are shown for issuance of a writ of certiorari and that the petition for the writ should be denied.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 490.

INTERNATIONAL COMPANY OF ST. LOUIS,
a Corporation,
Petitioner,

vs.

E. R. SLOAN, Receiver of The Federal Reserve Life Insurance Company, a Corporation, and
OCCIDENTAL LIFE INSURANCE COMPANY,
a Corporation,
Respondents.

BRIEF OF RESPONDENT OCCIDENTAL LIFE INSURANCE COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

GEORGE E. BRAMMER,
Counsel for Respondent.

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CLYDE B. CHARLTON,
LOUIS A. PARKER,
Of Counsel.

INDEX.

CASES CITED.

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BRIEF OF RESPONDENT OCCIDENTAL LIFE INSURANCE COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

An adequate statement of facts appears in the opinion of the Circuit Court of Appeals for the Tenth Circuit, filed July 12, 1940, not yet reported. A full statement of facts will be found in the Transcript of Record, beginning at page 71. There was no controversy as to the facts.

The Circuit Court of Appeals for the Tenth Circuit held (1) that the Certificate was the equivalent of preferred stock; (2) that the Certificate was intended by the parties thereto to apply only to a voluntary reinsurance, and (3)

that the sale and transfer of Federal Reserve assets to Respondent by a Receiver in insolvency proceedings, was, in legal effect, a foreclosure of the paramount lien held by former policyholders. The Court also specifically held that Respondent acquired from the Receiver only the assets in his hands, not policies as binding obligations of insurance for their respective face amounts.

SUMMARY OF ARGUMENT.

I.

The relation of the holder of the Participating Certificate to the policyholders and creditors of Federal Reserve is equivalent to that of a preferred stockholder.

One who pays money to a corporation and stakes it at the risk and hazard of the business is a stockholder; or if he cannot be so designated he is a joint adventurer with the stockholders and stands in no better position than a stockholder of the corporation.

If it be conceded that the Participating Certificate was intended to create a charge against assets superior to or on a parity with the rights of policyholders and creditors, which Respondent denies, the Certificate is contrary to public policy and void in so far as creditors of the corporation are concerned.

Warren v. King, 108 U. S. 389, 27 L. Ed. 769.
Hamlin v. Toledo, St. Louis & Kansas City R. R. Co., 78 Fed. 664.
Spencer v. Smith, 201 Fed. 647.
Ellsworth v. Lyons, 181 Fed. 55.
Wallerstein v. Ervin, 112 Fed. 124.
Synnott v. Tombstone Consolidated Mines Co., 208 Fed. 251.
In re Desnoyers Shoe Company, 224 Fed. 372.
In re Hicks-Fuller Co., 9 Fed. (2d) 492.
United States and Mexican Oil Co. v. Keystone Auto Gas & Oil Service Co., 19 Fed. (2d) 624.

In re Hawkeye Oil Co., 19 Fed. (2d) 151.
In re Lathrap, 61 Fed. (2d) 37.
In re Phoenix Hotel Co. of Lexington, Ky., 83 Fed. (2d) 724.

II.

The Participating Certificate, fairly construed, was intended by the parties thereto to apply only to a voluntary reinsurance by Federal Reserve of its outstanding policies, and did not contemplate, nor was it intended to apply to liquidating proceedings in insolvency wherein the assets of said company were transferred by the Receiver in consideration of Transferee's agreement to insure former Federal Reserve policyholders on terms acceptable to them and approved by the Court administering the insolvent estate.

The true meaning of the contract is to be determined by examining its terms in the light of the situation of the parties at the time it was made.

Where performance of a contract depends upon the continuing existence of a certain condition or state of things, or on the continuing existence of a certain thing, it is the intent and understanding of the parties that the contract shall cease to be operative if that condition or state of things, or that thing, ceases to exist.

$300,000.00 was paid to Federal Reserve for the express purpose of making good an impairment in trust funds held for the benefit and security of policyholders. Repayment of the Certificate was dependent upon solvency of Federal Reserve and its operation as a going concern on a profitable basis. In addition to contemplating solvency of Federal Reserve the parties to the Certificate contemplated that there would be outstanding policies of insurance which Federal Reserve could itself reinsure. Adjudication of insolvency and the appointment of a Receiver for Federal

Reserve, *ipso facto*, terminated its outstanding policies of insurance.

Moore v. Security Trust & Life Ins. Co., 168 Fed. 496.
Texas Company v. Hogarth Shipping Co., 256 U. S. 619, 65 L. Ed. 1123.
Israel v. Luckenbach Steamship Co., 6 Fed. (2d) 996.
LaCumbre Golf and Country Club v. Santa Barbara Hotel Co., 205 Cal. 422, 271 Pac. 476.
Anderson v. Yaworski, 120 Conn. 390, 180 Atl. 205.
Earn Line S. S. Co. v. Sutherland S. S. Co. (The Claveresk), 264 Fed. 276.
Lewis v. Mowinckel, 215 Fed. 710.
The Allanwilde, 248 U. S. 377, 63 L. Ed. 312.
Snipes Mountain Co. v. Benz Bros., 162 Wash. 334, 298 Pac. 714.
Layton v. Illinois Life Ins. Co., 81 Fed. (2d) 600.
Lorillard v. Clyde, 142 N. Y. 456, 37 N. E. 489.
In re 35% Automobile Supply Co., 247 Fed. 377.
Consolidated Arizona Smelting Co. v. Hinchman, 212 Fed. 813.
Equitable Trust Co. of New York v. United Box Board & Paper Co. et al., 220 Fed. 714.
Kansas Statutes, Sec. 40-404 (R. p. 85).
Indiana Statutes, Sec. 39-4207 (R. p. 86).
Missouri Statutes, Secs. 5704 and 5937 (R. p. 87).

III.

The Participating Certificate was at all times junior and inferior to the trust imposed by law on the assets in favor of Federal Reserve policyholders; and the sale and transfer of those assets to Occidental by a Receiver in insolvency proceedings was, in legal effect, a foreclosure of the paramount lien or interest of the policyholders. Stated differently, Occidental acquired the assets through a title paramount to any interest of the holder of said Certificate and therefore the provisions thereof are not binding on Occidental.

Assuming, without basis in fact or law, that a lien was created by the Certificate, it was junior and inferior to the paramount lien on assets in favor of policyholders.

The foreclosure of a paramount lien and a sale of assets pursuant thereto cuts off every right, title, lien or interest junior and inferior to the paramount lien.

Boston & Albany R. R. Co. v. Mercantile Trust & Deposit Co. of Baltimore, 82 Md. 535, 34 Atl. 778.
National Foundry & Pipe Works v. Oconto City Water Supply Company, 105 Wis. 48, 81 N. W. 125.
Hokanson v. Gunderson, 54 Minn. 499, 56 N. W. 172.
Moore v. New Orleans Waterworks Co., 114 Fed. 380.
Shaw v. Heisey, 48 Iowa 468.
Evans v. Atkins, 75 Iowa 448, 39 N. W. 702.
Porter v. Kilgore, 32 Iowa 379.
Nedderman v. City of Des Moines, 221 Iowa 1352, 268 N. W. 36.
Oil City Boiler Works v. New Jersey Water & Light Co., 81 N. J. Law 491, 79 Atl. 451.
Hobbs, Commissioner v. Occidental Life Ins. Co., 87 Fed. (2d) 380.
Consolidated Arizona Smelting Co. v. Hinchman, 212 Fed. 813.
Corpus Juris, Vol. 35, Par. 104, p. 67.
Phipps v. Chicago, R. I. & P. Ry. Co., 284 Fed. 945.
Daniel v. Layton, 75 Fed. (2d) 135.
Royal Union Life Ins. Co. v. Gross, 76 Fed. (2d) 219.
Kansas Statutes, Sec. 40-406 (R. p. 85).

ARGUMENT.

I.

(Applicable to Petitioner's Assignment of Error A.)

Petitioner's statement that the Fire Insurance Company of Chicago was not a stockholder when it advanced $300,000.00 evidenced by the Certificate is somewhat misleading. On page 76 of the Record is shown a stipulation disclosing

that prior to November 18, 1929, the Fire Insurance Company of Chicago agreed with the Insurance Investment Corporation to purchase a majority of the outstanding shares of stock of the Federal Reserve and to pay to the Federal Reserve $300,000.00 to be evidenced by the Participating Certificate. "Pursuant to said agreement the Insurance Investment Corporation, on November 18, 1929, advanced to the Federal Reserve, on behalf of the Fire Insurance Company of Chicago, $300,000.00 and received from the Federal Reserve said Participating Certificate; that on the same date, to wit, November 18, 1929, the Insurance Investment Corporation assigned and delivered to the Fire Insurance Company of Chicago said Participating Certificate and assigned and delivered, or caused to be assigned and delivered, to the said Fire Insurance Company of Chicago 15,100 shares of Federal Reserve stock, . . .", being a majority of outstanding shares.

It thus clearly appears that to all intents and purposes, and in legal effect, the Fire Insurance Company of Chicago was the controlling stockholder at the time an impairment in the reserves of Federal Reserve was corrected by the payment of $300,000.00, all of which was credited to the surplus account of Federal Reserve (R. p. 76).

At the time of the transaction under consideration the Fire Insurance Company of Chicago, the Federal Reserve and Insurance Investment Corporation were part of a group of companies engaged in trafficing in stocks of insurance companies, said group being managed and controlled by substantially the same coterie of individuals (R. p. 80). From November 18, 1929, to February 11, 1936, Federal Reserve was controlled by the Fire Insurance Company of Chicago or its Receiver (R. p. 76).

Petitioner purchased the Participating Certificate in 1936, for an undisclosed consideration (R. p. 76) at a time

when Federal Reserve receivership proceedings were pending and the company had for two years been denied a license to sell life insurance in any state (R. p. 82).

An attempt is made to distinguish the facts in the present controversy from those involved in many cases cited by Occidental, by asserting that the holder of the Certificate did not have "opportunity for unlimited gain which constitutes the difference between a stockholder and a creditor."

The record shows without controversy that on November 18, 1929, those in stock control of Federal Reserve were confronted with the alternative of making a contribution or having corporate activities of the company terminated. Prior to said date the Fire Insurance Company of Chicago had contracted to purchase stock control of Federal Reserve and to make good an impairment in its reserves by the payment of $300,000.00. Concern for the welfare of policyholders was not the primary reason for making such payment. The dominating motive behind the transaction was a desire to protect an investment in stock and the hope of profit growing out of control of a going concern.

The money evidenced by the Participating Certificate was subjected to the risk and hazard of the business. If, strictly speaking, the holder of the Certificate is not a stockholder, it is, in any event, a grub staker or joint adventurer with the corporation itself and can occupy no better position than a stockholder. The Certificate was payable solely out of profits and could be paid only in the event of successful and profitable operation; there is no due date. It is expressly provided that general assets are not subject to payment of the Certificate. The only assets received by Occidental were assets on deposit with state officials, constituting a trust fund for the benefit and security of policyholders. The Certificate, by its terms, shows that payment

thereof was subject to payment of all creditors of the company, not only policyholders but preferred creditors and ordinary creditors as well. Policyholding creditors were but partially paid and preferred and ordinary creditors received nothing at all (R. p. 92).

When a majority stockholder pays money to an insurance corporation to make good its reserves, making repayment subject and inferior to the rights of all creditors of the corporation to be paid, it is submitted that the money so paid by the stockholder is "special capital" and is, without question, staked at the risk and hazard of the business. It is immaterial whether one who pays money under such circumstances is designated technically as a stockholder or otherwise. The most that can be claimed for such a person is that he is an anomalous creditor. He is a creditor, however, only so far as stockholders are concerned and occupies a position identical with that of a first preferred stockholder.

In the instant case the holder of the certificate subjected the payment of its claim to the payment of all other creditors and occupies a position no better than that of a first preferred stockholder. The same rules apply to the so-called Participating Certificate as if it were technically a certificate of stock. If the Certificate purports to create an equitable charge, it is submitted that in so far as former policyholders of Federal Reserve are concerned, any lien or charge created by the Certificate was and is contrary to public policy and therefore void.

That the conclusion reached by the Trial Court, affirmed by the Circuit Court of Appeals, is sound is convincingly demonstrated by an overwhelming array of authorities. The cases cited by petitioner do not support its position. In *Ketchum v. St. Louis*, 101 U. S. 306, 25 L. Ed. 999, upon which petitioner chiefly relies, there was a statutory ap-

propriation of a definite portion of the future earnings of a railroad for a specific purpose. The statute provided for a custodian whose duty it was to take charge of earnings as they accrued and to apply the same. No action by the Railroad Company was required.

This Court analyzed the *Ketchum* case in *Tompkins v. Little Rock & F. S. R.*, 125 U. S. 109, 31 L. Ed. 615, saying: "In *Ketchum's* case the earnings of the road to the extent that they had been specifically appropriated to the County of St. Louis never did belong to the company after the bonds were accepted, and the grant of the earnings was in equity a grant of such an interest in the road as was necessary to produce the earnings." In the present case Federal Reserve policyholders had a first and paramount lien covering all assets acquired by Occidental. In the *Ketchum* case a mortgage on physical property, executed after a statutory grant of a portion of the earnings, was not a first and paramount lien.

II.

(Applicable to Petitioner's Assignment of Error B.)

Assets acquired by Occidental were assets held in trust by various state officials for the benefit and security of Federal Reserve policyholders. The Court determined that the best interests of policyholders would be served, not by sale of deposited assets piecemeal, but by using said assets for the purpose of purchasing insurance in some solvent company for such policyholders as desired to have their insurance protection resumed. The Court provided that any policyholder who did not desire to accept the benefits of the reinsurance agreement might take his equitable share of the value of the assets in cash. The method of liquidating deposited assets was in law and in fact the method

adopted by the persons who were the equitable and beneficial owners thereof.

On appraisal the value of deposited assets was ascertained to be so far less than the reserves required on outstanding policies on May 22, 1936, that it was necessary for the Court to impose a lien of 50% against the net equities of all policies. In the Reinsurance Agreement Occidental was bound to apply all savings and profits arising from assets acquired from the Receiver, in reduction of the lien imposed by the Court. Such earnings are to be so applied for a period of fifteen years unless the lien be sooner fully discharged.

It is Respondent's contention that the Certificate, when read as a whole and in the light of the circumstances of the parties thereto, and the respective rights in and to the assets of the policyholders on one hand and the Federal Reserve and those claiming under it on the other, was conditioned on the continuing solvency of Federal Reserve, and consequently the parties to said Certificate intended that it should cease to be operative in case of Federal Reserve's insolvency. When the parties inserted the provision relating to reinsurance it was contemplated that the company would have outstanding policies of insurance which it could itself reinsure. It is a firmly established rule that adjudication of insolvency and the appointment of a Receiver for an insurance company terminates outstanding policies and transforms policyholders into creditors.

The parties to the Certificate knew at the time of its execution that the law required the deposit of reserves for the sole benefit of policyholders. The very nature of the Certificate impels the conclusion that it must have been within the contemplation of the parties that Federal Reserve might some day become insolvent and incapable of continuing in the insurance business. That a Court might

assume jurisdiction over the affairs of the company, declare the same insolvent and appoint a receiver therefor, thus terminating the contract by operation of law, was reasonably within the contemplation of the parties.

Payment of the Certificate was dependent upon the solvency of Federal Reserve and its operation as a going concern on a profitable basis. The Certificate contemplated the performance of agreements contained therein by Federal Reserve as a going concern or by a reinsurer who might assume such obligations by a voluntary contractual arrangement with Federal Reserve. Prior to insolvency the Certificate was an executory agreement containing only promises of Federal Reserve. Paragraph 5 of the Certificate begins: "In the event of a reinsurance of the business of The Federal Reserve Life Insurance Company . . .". "Reinsurance" can refer only to insurance contracts of Federal Reserve. On May 22, 1936, outstanding policies were terminated by operation of law and deposited assets became a Trust Fund for the benefit of creditors. After May 22, 1936, former policyholders were creditors, holding, not policies, but claims. After May 22, 1936, Federal Reserve had no "business".

The Certificate, fairly considered and construed, discloses no purpose or intent on the part of Federal Reserve to do more than agree, in case of reinsurance voluntarily effected by Federal Reserve, to require the reinsurer, as a part of the transaction, to assume its obligations under said Certificate. While the Federal Reserve was a going concern it possessed power to control its own business and manage the same. In case it desired to reinsure its policies it was in a position to refuse to do so unless, as a part of the reinsurance arrangement, the reinsurer assumed its obligations under the Certificate. Federal Reserve had a right

to make an agreement with respect to reinsurance, and, prior to insolvency, was in a position to fulfill it.

It is submitted that the Certificate, fairly construed, was intended by the parties to apply only to a voluntary reinsurance by Federal Reserve, and did not contemplate nor was it intended to apply to liquidating proceedings in insolvency. Federal Reserve had no right or power to bind the purchaser of its assets from a Receiver in insolvency proceedings by an executory agreement made in 1929. The conclusion of the Trial Court is fully sustained by the facts and the law.

III.

(Applicable to Petitioner's Assignment of Error C.)

It should be borne in mind that petitioner's claim grows out of a liquidating receivership and that petitioner has disclaimed any charge against tangible assets. Petitioner's claim is to profits and savings arising from the assets subsequent to their acquisition by Occidental from the Receiver. Occidental acquired nothing from the Receiver except assets on deposit with various state officials. While petitioner disclaims a lien against assets, it asserts a lien on savings and profits arising from assets. It is submitted that a charge or lien against savings and profits to arise from assets is in substance and legal effect a charge or lien against the assets themselves.

Petitioner attempts to fasten a lien on savings and profits arising from the "insurance business of the Federal Reserve" as distinguished from tangible assets. After May 22, 1936, outstanding insurance contracts of Federal Reserve were liabilities, not assets. In *Hobbs, Commissioner v. Occidental Life Insurance Company*, 87 Fed. (2d) 380, the United States Circuit Court of Appeals for the Tenth

Circuit, determined the legal effect upon policies and policyholders of the adjudication of insolvency of Federal Reserve and the appointment of a Receiver therefor, saying:

> "It is well settled that upon the adjudication of insolvency and the appointment of a receiver on May 22nd, the policies of Federal Reserve were terminated as enforceable obligations for their respective face amounts, and the holders became creditors each for an amount equal to the then value of his policy . . . The privilege of thus participating in such assets was the only right which the holders had from the adjudication of insolvency until the reinsurance agreement became effective."

On the authority of the *Hobbs* opinion, and many other cases cited, it is plain Occidental acquired nothing from the Receiver except tangible assets.

For the purpose of illustration the Certificate will be assigned a fictitious position and accorded a status which it is not entitled to occupy and which petitioner does not claim for it. Without basis in fact or law, and solely for the purpose of argument, it will be assumed that the Certificate created a lien on assets. If a lien or charge was created by the Certificate, it was inferior and subordinate to the lien imposed on deposited assets in favor of policyholders. That the right, title, lien and interest of policyholders was paramount and superior to any interest, claim or charge in favor of the holder of the Certificate is shown not only by the terms of the various statutes under which Federal Reserve's assets were deposited (R. p. 23), but also by the terms of the Certificate itself. Furthermore, petitioner agrees that all deposited assets were held in trust for the exclusive benefit of policyholders.

It is the contention of Respondent that insolvency proceedings were in the nature of, and in legal effect, a foreclosure of the paramount lien in favor of former policy-

holders of Federal Reserve and that, having acquired said assets through a paramount title or interest, it is not bound by the Certificate. The facts set forth on page 28 of the Record show that what took place was, in legal effect, a sale of the assets to the highest bidder for cash. Advertisements were placed in newspapers and in insurance journals and a personal letter was written by the Receiver to every company authorized to transact business in Kansas, soliciting bids for the assets of Federal Reserve. Eight companies submitted bids. After a hearing in open Court and report of three independent actuaries who were selected to examine the various bids, the Court found that the best price that could be obtained was that offered by Respondent.

Sale and transfer of assets was made only after competitive bidding and the Court secured the highest and best price possible for the assets. The best price obtainable for the assets was not sufficient to pay policy-holding creditors. It was a judicial sale. On the proposition that the sale conducted by the Kansas Court in receivership proceedings was in fact a foreclosure, opinions in *Phipps v. Chicago R. I. & P. Ry. Co.*, 284 Fed. 945; *Daniel v. Layton*, 75 Fed. (2d) 135 and *Royal Union Life Ins. Co. v. Gross*, 76 Fed. (2d) 219, are instructive and convincing.

In the receivership proceedings the Court determined that deposited assets belonged to the policyholders. The only question remaining was how those assets were to be disposed of. The Court could have ordered the assets sold for cash and the proceeds distributed to former policyholders in partial satisfaction of their claims. Had this been done, petitioner would not have suggested that the purchaser of such assets for cash was bound by any provision of the Participating Certificate. It is only because the Court having jurisdiction of the insolvent company chose a method of liquidation more advantageous to the

policyholders than a sale for cash that petitioner asserts a claim against Respondent and the Receiver.

The Court gave each policyholder the option to take his share of the assets in cash or use the same for the purpose of purchasing insurance in a solvent company. The use to which the Court and the policyholders put deposited assets was merely a method of foreclosing the paramount lien of the policyholders against such assets. That the plan employed was the usual and customary method of liquidating a trust for the sole benefit of policyholders is well recognized. Many states have statutes governing life insurance companies which provide that deposited securities, in event of insolvency, may be sold or used to purchase reinsurance. Liquidation occurred when the Court, with the consent of former policyholders of Federal Reserve, sold the deposited assets to Respondent in consideration of its agreement to insure the lives of such policyholders. The sale was a judicial sale; it was a judicial sale to foreclose a paramount lien. The purchaser at such sale acquired the assets through the paramount title and lien of the policyholding creditors, and, having done so, it took the assets free from liability on account of the Certificate.

ADDITIONAL DEFENSES.

In addition to defenses discussed and approved by the Circuit Court of Appeals, several other defenses were interposed by Respondent. Each of said defenses constitutes an effective bar to the claim asserted by petitioner and the Trial Court so held. Three such additional defenses are here set forth.

A.

The Participating Certificate created no lien or encumbrance against the assets of Federal Reserve and conse-

quently the Receiver took said assets free from any liens or encumbrances; and the Receiver having sold said assets free from liens and encumbrances Occidental is not bound to pay Petitioner any profits arising therefrom.

Tompkins v. Little Rock & F. S. R., 125 U. S. 109, 31 L. Ed. 615.
Hakes v. North, 199 Iowa 995, 203 N. W. 238.
Kuppenheimer & Co. v. Mornin et al., 78 Fed. (2d) 261.
Consolidated Arizona Smelting Co. v. Hinchman, 212 Fed. 813.
Eureka Development Co. v. Clements, 44 Idaho 484, 258 Pac. 371.
In re Lathrap, 61 Fed. (2d) 37.
In re Clark Realty Co., 234 Fed. 576.
Silent Friend Mining Co. v. Abbott, 7 Colo. App. 73, 42 Pac. 318.
Union Trust Co. v. Curtis, 182 Ind. 61, 105 N. E. 562.
Metropolitan Life Ins. Co. v. Whitestone, 77 Fed. (2d) 255.
Sherwood v. Atlantic & D. R. Co., 94 Va. 291, 26 S. E. 943.
Gulf, C. & S. F. Ry. Co. v. Newell, 73 Tex. 334, 11 S. W. 342.
McMaster v. R. Emerson and George Stacy, 109 Iowa 284, 80 N. W. 389.
Simmons v. Anderson, 44 Minn. 487, 47 N. W. 52.
United States Nat'l Bank of LeGrande v. Wright et al., 131 Ore. 518, 283 Pac. 1.
Sims v. Jamison, 67 Fed. (2d) 409.
City of Menasha v. Milwaukee & Northern R. R. Co., 52 Wis. 414, 9 N. W. 396.

B.

A lien on future profits cannot attach until such profits come into existence and then only to such interest therein as is then held by the Lienor. No profits could accrue to Federal Reserve after its adjudication as an insolvent and the appointment of a Receiver; hence there can be no lien

on profits arising from assets acquired by Occidental from the Receiver.

McMaster v. R. Emerson and George Stacy, 109 Iowa 284, 80 N. W. 389.
Gerard Trust Company v. Standard Gas Co., 93 N. J. Eq. 307, 115 Atl. 910.
Sims v. Jamison, 67 Fed. (2d) 409.
Simmons v. Anderson, 44 Minn. 487, 47 N. W. 52.
United States National Bank of LaGrande v. Wright et al., 131 Or. 518, 283 Pac. 1.
Consolidated Arizona Smelting Co. v. Hinchman, 212 Fed. 813.
Eureka Development Co. v. Clements, 44 Idaho 484, 258 Pac. 371.

C.

The Participating Certificate was a mere executory agreement which was automatically terminated upon adjudication of insolvency of Federal Reserve and the appointment of a Receiver; and the Receiver did not adopt, affirm or approve the Certificate.

United Electric Securities Co. v. Louisiana Electric Light Co., 71 Fed. 615.
General Electric Co. v. Whitney, 74 Fed. 664.
Lovell v. St. Louis Mutual Life Ins. Co. et al., 111 U. S. 264, 28 L. Ed. 423.
Seaboard Small Loan Corp. v. Ottinger, 50 Fed. (2d) 856.

CONCLUSION.

Respondent does not claim that the Participating Certificate was an invalid contract between the original parties, but it is asserted that it does not constitute a charge or lien against assets acquired by Respondent from the Receiver or against profits arising therefrom.

Principles of law set forth in the Trial Court's conclusions (R. p. 171) are salutary and firmly established by an

overwhelming array of authorities. It is stated with confidence that the cases cited by Petitioner do not support the claim asserted.

Petitioner has shown no valid or substantial reason entitling it to a review on writ of certiorari. The decision of the Circuit Court of Appeals is in harmony with rules uniformly adopted and followed by the Courts, both Federal and State. Alleged errors are without merit. Petitioner has not presented an appropriate case for review by this Court and its prayer for a writ should be denied.

Respectfully submitted,

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